



# Treasury Trends

*Bringing currency to the Arizona Taxpayer*

**David A. Petersen, State Treasurer**

March 2004

Volume 2, Number 3

This month's  
definition ---

## **Character:**

*The qualities built  
into an individual's  
life that determine  
his or her response,  
regardless of  
circumstances*

**Both LGIP Pools  
continue to  
outperform their  
benchmarks in  
February 2004**

**Higher yields  
can't be  
manufactured. To  
increase yields,  
there must be a  
reduction in  
liquidity or an  
increase in risk.**

## LGIP Performance

The Board of Investment, in the regular meeting held on March 17, 2004 was informed of the performance of the LGIP and LGIP-Gov pools. Both pools continued to outperform their benchmarks. Balances of the pools also remained relatively stable for the month.

| <b>Yields</b>        | <b>LGIP</b>    | <b>LGIP<br/>Index</b> | <b>Diff</b> | <b>LGIP-GOV</b> | <b>3 mo.<br/>T-Bill</b> | <b>Diff</b> |
|----------------------|----------------|-----------------------|-------------|-----------------|-------------------------|-------------|
| Pool size →          | <b>\$2.2 B</b> |                       |             | <b>\$1.2 B</b>  |                         |             |
| <b>January '04</b>   | 1.41           | .85                   | +56         | .98             | .89                     | +09         |
| <b>Feb '04</b>       | 1.44           | .85                   | +59         | 1.00            | .93                     | +07         |
| <b>March '03</b>     | 1.59           | 1.09                  | +50         | 1.35            | 1.14                    | +21         |
| <b>April '03</b>     | 1.62           | 1.06                  | +56         | 1.18            | 1.14                    | +04         |
| <b>May '03</b>       | 1.73           | 1.03                  | +70         | 1.21            | 1.08                    | +13         |
| <b>June '03</b>      | 1.88           | .99                   | +89         | 1.54            | .93                     | +61         |
| <b>July '03</b>      | 1.58           | .85                   | +73         | 1.44            | .90                     | +54         |
| <b>August '03</b>    | 1.51           | .83                   | +68         | .97             | .96                     | +01         |
| <b>September '03</b> | 1.48           | .83                   | +65         | .97             | .95                     | +02         |
| <b>October '03</b>   | 1.43           | .83                   | +60         | .97             | .93                     | +04         |
| <b>November '03</b>  | 1.43           | .85                   | +58         | .99             | .94                     | +05         |
| <b>December '03</b>  | 1.44           | .88                   | +56         | .98             | .90                     | +08         |

## LGIP Historical Perspective

Some observers have noted the yields on LGIP 5 are not as high as they have been historically. The answer to that is "true." But, the yields in the market are not as high as they have been in the past. The real question is, "How is LGIP 5 doing relative to what is available in the market?" Portfolio managers in the Treasurer's office are concerned about the risks they take in relation to the market as a whole. When priorities are safety, liquidity and yield, we are constrained to buy the prevailing market rates. **Higher returns cannot be manufactured.** Yields higher than the market rate come only from reduced safety or liquidity.

To judge our performance, we look at the prevailing market. Traditionally the benchmark for LGIP 5 has been other LGIP's tracked by S&P. By that measure, LGIP 5 is performing admirably. Some, however, feel we should use a different benchmark. One comment heard was that LGIP 5 traditionally yielded the same

**Pooled  
Investments tend  
to have higher  
yields in down-  
trending interest  
rate  
environments.**

**LGIP Pool 5  
performing  
according to  
historic trends**

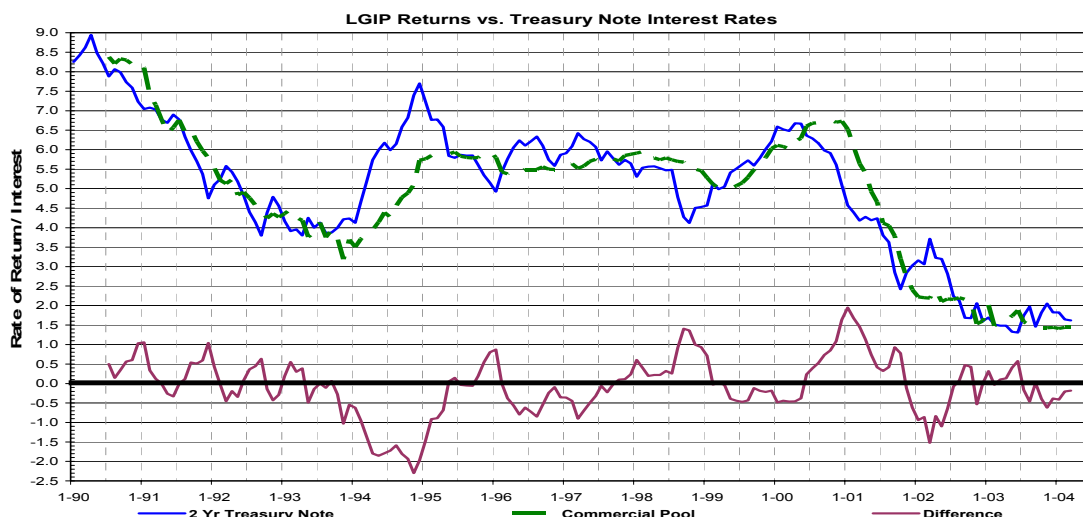
David A. Petersen  
Arizona Treasurer  
1700 W. Washington  
Phoenix, AZ 85007

Phone:  
(602) 542-5815

Fax:  
(602) 542-7176

We're on the Web!  
[www.aztreasury.state.az.us](http://www.aztreasury.state.az.us)

as the 2-yr Treasury note. Because the yield on LGIP 5 has been slightly lower than the 2-year Treasury, it was claimed our performance recently was not up to historical standards. Taking that observation to heart, we looked at the historical relationship between the 2-year Treasury yield and the yield on LGIP 5. What we discovered is illustrated in the following graph.



Historically, when interest rates are falling, LGIP 5 tends to yield more than the 2-year Treasury note. When market rates are rising, LGIP 5 tends to yield less than the 2-year note. Since interest rates have both risen and fallen over the past year, there have been periods when LGIP 5 has yielded above and below the 2-year Treasury note. This result is expected because pooled assets will respond slower to changes in interest rates than do the daily prices of Treasury notes. Even though LGIP 5 is currently yielding slightly less than the 2-year note, we are closing the gap as interest rates have fallen into a tighter trading range.

The amount of LGIP 5 yield over or under the 2-year note depends on the day in question. March 23, the yield on the 2-year note was 1.47%. The February yield on LGIP 5 was 1.44%. Very close. As of March 30, the yield differential had widened slightly. This shrinking and widening of the yield gap between the 2-year note and LGIP 5 is a function of the stability of yields in the pool versus the volatility of the yields in the daily market.

LGIP 5 gives a competitive yield with a shorter duration (thus less interest rate risk) and greater liquidity than is available from the 2-year Treasury. Question to consider: With inflationary pressures starting to appear and an expected Federal Reserve rate increase in the next 6 to 8 months, does it seem prudent to increase interest rate risk and tie up cash for two years to temporarily pick up 3 – 20 basis points?

## Yield Curve Perspective

| Treasury Yield Curve |        |                |                 |                |
|----------------------|--------|----------------|-----------------|----------------|
| Term                 | 30 Mar | 1 Week Earlier | 1 Month Earlier | 1 Year Earlier |
| 3 mo.                | .95    | .94            | .95             | 1.11           |
| 6 mo.                | 1.00   | 1.00           | .99             | 1.11           |
| 2 yr.                | 1.62   | 1.47           | 1.65            | 1.48           |
| 3 yr.                | 2.00   | 1.87           | 2.11            | N/A            |
| 5 yr.                | 2.85   | 2.66           | 2.95            | 2.71           |
| 10 yr.               | 3.89   | 3.69           | 3.97            | 3.80           |
| 30 yr.               | 4.81   | 4.65           | 4.84            | 4.82           |

